switched access services.[30] Unfortunately, the Commission simultaneously proposes to replace the waiver process with a new regulatory obstacle. Instead of seeking a waiver, LECs would be required to petition the Commission to establish new rate elements and to demonstrate that the new offering would serve the public interest.[31] In the petition, the LEC would have to describe the service to be offered and alternative ways in which the rate elements might be established. The Common Carrier Bureau would be delegated authority to specify the types of elements that would be acceptable for the proposed service.[32]

The benefits to be obtained by eliminating the Part 69 waiver requirements are more than offset by the new regulatory procedures the Commission proposes to implement. Part 69 rate structure limitations already represent an extreme form of regulation, and, indeed, are an aberration. Never before or since the establishment of Part 69 has the Commission had such constrictive tariff regulations. They are incongruous with the scheme of carrier-initiated rates embodied in the Communications Act.[33]

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30. See Hausman Statement at ¶ 37 ("While price of regulation is designed to provide the appropriate economic incentives for LECs to offer innovative services, the Part 69 waiver process directly decreases the incentives for innovation.").

31. Second Notice at ¶ 71.

32. Another element of the Commission's proposal is that once a petition is granted other LECs could submit a letter certifying an intention to provide the same service, using the same elements. The Common Carrier Bureau would have a fixed time within which to act on the certification. If the Common Carrier Bureau fails to act within the specified time, the authority to establish the new element would be deemed granted. If the Common Carrier Bureau denies the certification, then the LEC would have to file a Part 69 waiver.

33. See AT&T v. FCC, 482 F.2d 865 (2d Cir. 1973). Title II of the Communications Act contemplates a process by which common carriers file with the Commission rates and rate structures for the services they propose to offer. Only if such filing raised questions of lawfulness should the Commission investigate such filings. For all common carriers except LECs, this is the way in which the Commission administers Title II regulation. The LECs alone, by virtue of Part 69, must seek Commission permission before they can initiate a

The Commission may have justified its extreme intervention in the LECs' provision of switched access services in order to control interexchange competition and to assure that AT&T did not obtain any advantage because of its size and dominance in that market. Having now found that AT&T is not dominant, there is no discernible basis upon which to continue to constrain the LECs' rate structures.

In any event, allowing LECs to file new services without having to submit to a prefiling process does not constitute a relinquishment of the Commission's control and management of switched access. The existing elements prescribed by the rules would be retained, and cannot be eliminated or restructured without prior approval of the Commission.

The Commission repeatedly states its intent to promote competition and expand consumer choices. BellSouth believes that the proposed regulations with respect to Part 69 are inconsistent with that intent. The proposed rate structure limitations instead create barriers that prevent the LECs from being responsive to customer demand -- a result which is not in the public interest.

The Commission should modify the Part 69 rules so that the LECs can file tariffs for new services without first asking the Commission's permission. In so doing, the Commission should acknowledge that there is a presumption in favor of new services introduction. What is not needed is a new regulatory process to replace the waiver. Instead, the Commission should return to the statutory paradigm of carrier-initiated rates.

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carrier-initiated structure change for switched access.

Issue 4b

How should any new procedures with respect to Part 69 waivers be coordinated with the process for determining whether a new service is a Track 1 or Track 2 service as defined in the previous subsection herein if those concepts are adopted?

The approach most consistent with the new service rules would be to eliminate any requirement that a LEC obtain pre-approval before it files for a new service.[34] Nevertheless, if the Commission is going to impose a new regulatory requirement that must be satisfied before the LECs can file a new service, then that requirement should minimize the regulatory delay that a LEC encounters prior to filing its new services. To be consistent, with BellSouth's proposed concept of a presumption that new services are Track 2, and Track 1 services are the exception, the process should consist of nothing more than a Notice of Intent to file given 15 days prior to filing. The notice would describe, in general terms, the service to be offered. (A review of the specific rate element is best left to the tariff review process.) If there is no objection lodged within 14 days, the filing would be made in accordance with the new service rules. The Commission should require any party filing an objection to overcome the presumption that the new service is in the public interest by demonstrating specific harm to the public or that the new service contravenes public policy. If an objection is submitted, the Commission would have five days in which to issue an order denying permission to file on the basis of a preliminary determination that the new service will be substantially adverse to the public interest. The LEC would have the right to obtain

34. See Hausman Statement at ¶ 36 ("Given the large expected gain in consumer surplus and economic efficiency from the introduction of new services, the Commission should remove all obstacles which retard their introduction.").

expedited review of any such determination. It could file a petition within 15 days of the denial, with the Commission issuing an order within 30 days thereafter.

E. Elimination of Lower Service Band Index Limits and Other Pricing Flexibilities.

Issue 5a

Should we further expand or eliminate the lower service band index limits for all access services? Does there remain a danger of predatory pricing or other anti-competitive practices? Would this additional downward pricing flexibility harm any LEC customers? Would it harm competition?

In the Second Notice, the Commission proposes to eliminate the lower service band limits that currently apply to service categories in the trunking and traffic sensitive baskets.[35] BellSouth supports this proposal. Such action will increase LEC pricing flexibility and allow price cap LECs to move prices closer to economic costs,[36] and the result will be more efficient pricing by the LECs in a manner that benefits customers and competition.

The current limitations on downward price adjustments are unnecessary restrictions that sacrifice efficiency and consumer welfare gains. A fundamental premise of price cap regulation is that consumers will benefit from lower prices and improved services in much the same way they would if the marketplace were fully competitive. It makes no sense to insist that removal of constraints on price reductions must await competition.[37]

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35. Second Notice at ¶ 75.

36. Id. at ¶ 83.

37. The presence of competition obviates the need for any type of price regulation by the Commission. The application of price cap rules presumes that competition is not present. The relevant inquiry is whether the rules are reproducing the outcomes that would be expected if competition were present.

By removing the constraints, the Commission establishes a necessary condition for price caps to replicate the performance of competitive markets.[38]

Apart from permitting LECs to realize additional efficiencies from greater pricing freedom, there are strong competitive reasons for removing the limits on price reductions. Such limits artificially inflate access prices, and create a price umbrella that invites inefficient entry and thwarts price competition. New entrants have no incentives to be efficient and reduce prices while the LECs are precluded from moving prices toward economic costs. This result is not consistent with the purpose of price caps, nor is it consistent with the goal of promoting competition. In short, it is not what the Commission is seeking to achieve.

The predatory pricing concern raised in the Second Notice is not realistic. As Dr. Hausman observes, predatory pricing generally is an extremely unlikely outcome in modern telecommunications.[39] Moreover, the check on anticompetitive pricing behavior is the same that exists in nonregulated markets -- the antitrust laws. These statutes have considerable consequences that act as an effective control on predatory behavior. In addition, the Commission itself retains substantial tools by which to police and deter anticompetitive pricing. It retains under the Communications Act the power to investigate, on its own motion, any suspicious pricing behavior.[40] Moreover, Section 208 continues to

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38. See Hausman Statement at ¶ 25 ("No reason exists to limit the amount of LEC downward pricing flexibility because lower prices benefit consumers and benefit competition as output increases . . . . Maximum pricing flexibility is thus the appropriate policy of the Commission and should not depend on levels of competition.").

39. See id. at ¶¶ 19 - 24.

40. See, e.g., 47 U.S.C. § 205.

afford third parties a ready means by which to challenge any price filed by a LEC through the filing of a formal complaint.

These mechanisms are not only effective, but also are far more consistent with the goals of price regulation than maintaining arbitrary limits on price reductions. Moreover, while removal of the pricing limitations makes sense regardless of the presence of competition, the Commission need not ignore the fact that competitive networks are and continue to be deployed, legal barriers to local competition are disappearing and there exists a large, powerful, financially well-heeled fringe of potential competitors -- the interexchange carriers -- who can enter and are entering the market at a moment's notice. In light of these circumstances, a LEC could not successfully engage in anticompetitive pricing.[41]

The Commission's focus should be to improve the efficiency of the price cap rules and to eliminate needless constraints. Modifying the price cap rules to remove the lower pricing limits on the service bands in the traffic sensitive and trunking baskets will accomplish both objectives. As Dr. Hausman observes, consumers will benefit and economic efficiency will increase if LECs choose the lower prices, regardless of the level of competition in access or local exchange markets.[42]

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41. Conceptually, predatory pricing involves pricing below costs to drive competitors out of the market. After competition is eliminated, prices can be raised to recoup losses. The ability of a LEC to successfully engage in such behavior is nonexistent. Even assuming a competitor exited the market, the alternative supply capacity is permanent. Any attempt by a LEC to increase prices would simply be met by a new entrant obtaining the existing capacity at a reduced cost. See Hausman Statement at ¶¶ 20 - 21.

42. Id. at ¶ 10.

Issue 5b

Should we place additional limits on the ability of a LEC that decreases prices pursuant to this flexibility to subsequently increase those prices in order to preclude the potential for anticompetitive pricing strategies?

The Commission questions whether additional constraints on increasing prices should be imposed on LECs who decrease prices in the event that the lower pricing limits are removed. It would be a mistake for the Commission to adopt such limitations.[43] Removal of the lower price limits on the service categories will improve the efficiency of the existing price cap plan. On the other hand, creating new upper price limits would have exactly the opposite effect, and would likely establish a set of pricing parameters that is even less efficient than the existing rules.

Second, regulatory pricing constraints are unnecessary as a check against the potential of anticompetitive pricing. As discussed above, and as Dr. Hausman has shown, there are other mechanisms that are more effective in performing this function that do not carry the disincentives and inefficiencies attributable to price constraints.[44]

Furthermore, limiting price increases after a price reduction can chill the incentives to make pro-competitive price reductions in the first place. Such rules impose a severe penalty for mispricing a service. If any price reduction is accompanied by a regulatory fiat that limits future upward price adjustments, then that set of rules rewards

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43. Even in considering this option, the Commission may misperceive the way in which upper pricing limits for service categories operate. The Second Notice (¶ 83) states that the upper limit (currently 5 percent) adjusts each time a LEC makes a price reduction. To the contrary, pricing band limits of a service band index create a range that is relative to the PCI and changes annually relative to the PCI change. The upper and lower limits do not adjust to price changes.

44. See Hausman Statement at ¶¶ 19 - 24.

behavior that keeps prices as high as possible. By removing the ability of the carrier to increase prices after it elects a price decrease, the carrier cannot afford to take the risk of lowering prices because if a particular price set is subsequently determined by the LEC to be below optimum level (although not predatory), the regulatory rules may not permit adjustment.[45]

In a rapidly changing environment it is unrealistic to presume that there is a narrow range of rates that maximizes efficiency and consumer welfare. The more the Commission attempts to impose regulatory limits around service prices, the less likely it will be that the regulatory scheme will emulate the competitive market. The ultimate loser in such a situation will be the consumer.

Issue 5c

> *Are there any other pricing flexibilities which we should adopt to promote cost-based pricing? How would the proposal promote our objectives? Would added flexibilities cause competitive harm? What is the relationship between downward pricing flexibility and the varying cost, demand, and other characteristics of different geographic markets? Should additional pricing flexibilities be considered in this proceeding or in another context?*

There are other changes that the Commission should introduce to the LEC price cap plan that would further enhance the operational efficiency of the price cap rules. To date, the price cap rules permit zone pricing on a relatively limited basis. Zone pricing

45. Professor Hausman has shown that limiting price increases can have the perverse effect of keeping prices artificially high. The California Public Utilities Commission (CPUC) initially prevented cellular companies from raising rates after a price decrease unless they underwent a full rate of return hearing. During the period this rule was in effect, cellular prices did not decrease. After the CPUC revised its rule and removed restrictions on cellular companies ability to raise prices, cellular rates fell by fifteen percent within a short period of time. Hausman Statement at ¶ 17.

should be extended to all baskets and service categories, but in particular to local switching, carrier common line and the interconnection charge (RIC).[46]

Extending zone pricing makes sense in several respects. Zones reflect different levels of traffic density. The traffic characteristics that define the zones, however, are not confined exclusively to transport facilities. To the contrary, they apply equally across the entire network. Indeed, the network is designed and engineered as a whole, not according to artificial price cap categories. Thus, the characteristics that justify zone pricing for transport services pertain equally to all other elements of access services.

By extending zone pricing, the Commission will enable each LEC to develop a consistent set of prices for its services. That benefit will inure primarily to consumers in the form of more rational access pricing structures.

The current limitations on zone pricing are the product of antiquated rules that have little basis for continuation. When the Commission adopted its access charge rules, it specified that access charges could not be de-averaged below a study area -- a rule that today prevents LECs from unilaterally establishing zone prices. Twelve years ago, when the rule was adopted, conditions were sufficiently different and characterized by a large degree of uncertainty. A principal concern was the impact that de-averaged access rates would have on nationwide average toll charges. Experience has now shown that de-averaging access prices does not lead to de-averaged toll charges. Furthermore, the Commission has just declared AT&T nondominant, signifying that it is prepared to have the marketplace control toll services.

46. See Hausman Statement at ¶¶ 14 - 15.

In these circumstances, the Commission should abandon constraints on LEC pricing that were established for the purpose of managing the interexchange marketplace. The Commission should now focus on eliminating regulations that prevent LECs from establishing efficient prices. One such regulation is the averaging requirement.

The Commission itself has acknowledged that zone pricing is reasonable. The difficulty here is that it has tied zone pricing to competition.[47] Linking zone pricing to competition is inappropriate. If the Commission believes that zone pricing serves the public interest and should be permitted where there is competition, then zone pricing should be permitted in the absence of competition as well. Regulation should to emulate the outcomes that are expected in a competitive market. There is no question that zone pricing is one of those outcomes. Accordingly, a sound regulatory policy would permit such pricing regardless of the presence of competition.

Finally, in addition to zone pricing flexibility, the Commission should authorize bulk billing as an alternative way to recover costs associated with the carrier common line. Such an approach would foster more efficient pricing, since common line costs are generally incurred based on the number of loops that are in service. Bulk billing

47. While the Commission's basis for zone pricing was that zones should reflect "cost-related factors such as density", in the Expanded Interconnection order, the Commission triggered the implementation of zones upon a competitive showing -- an operational expanded interconnection cross connect. Expanded Interconnection with Local Telephone Company Facilities, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992), at ¶¶ 172-86.

would be an efficient pricing structure because the message based price would more closely align common line cost recovery with the way that common line costs are incurred.[48]

F. Revision of Baskets and Consolidation of Service Categories.

Issues 6a, 6b, 6c and 7a, 7b, 7c (Combined Response)

> *Under what circumstances should the price cap baskets be revised? Can revisions be planned to take place automatically on achievement of particular milestones or must they be done on an individual basis or after a periodic review? If they can be planned to take place on achievement of particular milestones, what should those milestones be? Should any individual review of the basket structure be done as part of a rulemaking proceeding? Are there any other procedures that would be appropriate?*
>
> *As competition develops at different rates for different services within different geographic markets, should different basket structures be established for a particular LEC or within a particular study area or even within a smaller geographic area?*
>
> *Would any service category consolidations serve our goals in this proceeding? If so, explain how they would serve those goals. Would there be any adverse effects on end-users or competition?*
>
> *Under what circumstances can consolidation of service categories occur?*
>
> *If service categories are combined, how should the relevant SBIs and the SBI upper and lower limits be adjusted?The Commission currently uses tariff regulations and price cap ceilings applied to a number of separate service baskets as the fundamental means for ensuring that rates fall within a zone of reasonableness. The essence of BellSouth's proposals to modify the basket and band structure is to eliminate those price cap constraints that serve no legitimate regulatory purpose and that only interfere with the efficiencies and incentives that price caps are intended to create. These modifications should be made, not because of the emergence of competition, but because they are needed to ensure that the price cap plan has the appropriate attributes to achieve the Commission's price cap goals. Levels of competition, actual or expected, do not bear upon the immediate need to make changes to the existing basket and banding requirements, of the price cap rules.*

48. The carrier common line amount would be apportioned among interchange carriers on the basis of each carrier's relative interstate revenues.

BellSouth does not propose any changes to the number of price cap baskets. Of the five baskets that are defined by the LEC price cap rules, only two -- the traffic sensitive basket and the trunking basket -- have service categories. Accordingly, BellSouth's proposals pertain to these two baskets. Attachment 2, presents the revised service category structure that BellSouth proposes, and the proposed modifications are discussed below.

1. **Trunking Basket**

Under the current rules, there are six service categories within the trunking basket: (1) voice grade entrance facilities, voice grade direct-trunked transport, voice grade dedicated signalling transport; voice grade special access; WATS special access, metallic special access, and telegraph special access services; (2) Audio and Video services; (3) High Capacity and Digital Data Service (DDS);[49] (4) Wideband Data and Wideband Analog service; (5) Tandem-switched transport; and (6) the Interconnection charge.

BellSouth proposes that the six service categories be consolidated into three: (1) Dedicated Transport, (2) Tandem Switched Transport and (3) the Interconnection Charge. The Dedicated Transport and the Tandem Switched Transport service categories would each have a 5 percent upper pricing limit.[50] The Interconnection service category would continue to have no upward pricing flexibility as is currently the case.

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49. There are two subindices associated with the High Capacity service category: the DS1 subindex and the DS3 subindex.

50. The upper pricing limit would continue to be calculated as it is under the current rules and would be adjusted annually relative to the change in the PCI.

2. **Traffic Sensitive Basket**

The Traffic Sensitive basket currently has four service categories: (1) local switching; (2) information; (3) database access; and (4) billing name and address (BNA). Of these four service categories, only two were part of the original price cap plan. The database and BNA service categories were recently added to the Traffic Sensitive basket for the purpose of managing the prices of two new services offered by the LECs.[51]

BellSouth proposes that the number of service categories be reduced to three. The BNA service category would be eliminated. BNA services would be included in the Information/DA service category. This service category would also be expanded to include operator services and call completion services. The database service category would be enlarged to include LIDB[52] and all database services developed in the future.[53]

3. **Conclusions Regarding Basket and Banding Proposals**

BellSouth's proposed modifications are modest but would measurably improve the performance and attendant benefits of price caps. Redefinition of the service categories eliminates pointless restrictions in the current rules. For example, numerous service categories have been created that currently serve no legitimate purpose. While the Commission in the transport restructure proceedings has been concerned with differences between dedicated transport and tandem switched transport, BellSouth's proposal continues

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51. See In the Matter of Provision of Access for 800 Service, Second Report and Order, 8 FCC Rcd 907 (1993) ("800 Database Access Order"); In the Matter of Policies and Rules Concerning Local Exchange Carrier Validation and Billing Information for Joint Use Calling Cards, Second Report and Order, 8 FCC Rcd 4478 (1993).

52. LIDB services are currently included in the trunking basket.

53. The subcategory for 800 vertical services would be eliminated.

to addresses that concern.[54] The advantage of BellSouth's proposal is that it recognizes that for dedicated transport, technology and customer demand have singled out high capacity services as the preeminent transport services. Maintaining multiple dedicated transport service categories with their pricing constraints serves no legitimate regulatory purpose.

Similarly, the proposed changes to the traffic sensitive service categories are intended to make the category structure more efficient. For example, under the current rules, the database service category includes only a single service. This is also true for the BNA service category. These are the functional equivalents of specific-service bands that were recognized as too restrictive when the LEC price cap plan was adopted in 1991.[55] BellSouth's proposal enlarges the service category definitions so that price management under the rules is more efficient.

Redefining the service categories as proposed by BellSouth would also serve to better align the price cap plan as a transition mechanism to competition. The modifications proposed by BellSouth afford LECs a greater opportunity to price their services in the same manner as firms operating in an effectively competitive market. This replication of competitive market outcomes is a stated objective of the Commission in implementing the price cap plan.

Failure to make at least these modest modifications to the price cap plan will create or perpetuate price regulations that in effect compel LECs to price services at

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54. Transport Rate Structure and Pricing, Second Report and Order, 9 FCC Rcd 615 (1994).

55. Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786 (1990).

economically inefficient levels. Such a result subverts the role of price caps as a transition mechanism to competition because the Commission can never discover how competitive the market is. Forcing LECs to engage in inefficient pricing merely creates a regulatory price "umbrella" under which new entrants will seek to expand their operations. The ability of LEC competitors to exploit artificially inflated profit opportunities will provide little information about the true emergence of sustained market-based competition.

The objective of the Commission in revising the basket and banding requirement of the price cap rules should be to assure that the rules permit a structure of prices which replicates a competitive market. It is not the presence of competition that mandates pricing flexibility, but instead a recognition that regulation (i.e., price caps), like competition, is a means of producing economically efficient price structures.

Competition should not be the measure for modifying price caps. Instead, competition is the justification for the removal of all pricing limitations. As discussed more fully below, as competition develops, substantial competition should be the trigger for removing services from price cap regulation. Ultimately, competition will justify declaring LECs nondominant and affording them the maximum flexibility to function like any other firm operating in a competitive market without any regulatory hindrance.

G. Further Notice of Proposed Rulemaking in CC Docket No. 93-124 -- Operator Services and Call Completion Services.

Issues 8, 9a and 9b (Combined Response)

Should operator services be placed in its own service category in the traffic sensitive basket or combined with another new or pre-existing service category?

What is the proper price cap treatment of operator-related call completion services?

What is the proper price cap treatment of directory assistance-related call completion services?

The Second Notice solicits comment regarding the appropriate price cap treatment for operator services, call completion services and directory assistance. In response to Issues 6 and 7, BellSouth proposed redefining service categories for the Traffic Sensitive basket. As part of this proposal, BellSouth would include operator, call completion and directory assistance services in a single service category. Recognizing that service categories reduce the efficiency of a price cap plan, the objective must be to minimize such inefficiencies by defining service categories in a manner that affords at least a minimum opportunity for the LEC to create an efficient set of prices. The category that BellSouth proposes would group similar ancillary services in a category that is sufficiently broad to allow this to occur.

H. General Issues and Measures of Competition.

Issues 10 and 11 (Combined Response)

As to each proposed relaxation of regulation and pricing flexibility, should LECs be permitted to take advantage of the regulatory relief and pricing flexibility at this time or should they first have to make a showing that a certain level of competition exists before being able to use it? If a showing should be required, what should the showing be and why?

What is the relationship between the various regulatory relief and pricing flexibilities we are proposed and should any restrictions be placed on the ability of a LEC to take advantage of one type of relief or flexibility in combination with another? Should some relief be granted only after successful implementation of other forms of relief, or are there other sequencing concerns we should consider?

Should we impose new limits on subsequent upward pricing flexibility after a price has been reduced? If so, what should those limits be? If such limits are unnecessary, explain why they are not needed to protect consumers and to insure a competitive marketplace.

Which of the changes discussed in Section IV.B herein, if any, should be predicated on a demonstration that certain barriers to entry have been removed, and why? If such a demonstration should b required, should a competitive checklist be used and, if so, what should be included in it? Are there any other tests for the existence of competition that should be used to determine whether regulatory relief and pricing flexibility should be granted? Should any of the proposed changes to our price cap rules be predicated on a demonstration of actual competition or upon some other circumstances and, if so, why?

In addition to adopting a "competitive checklist", are there other steps that need to be taken to ensure competition in the interstate access market. For example, is it necessary for the LECs to separate local bottleneck facilities, such as loops and switching, through a separate subsidiary, and to provide these facilities to all access providers at "wholesales prices"?

In the Second Notice, the Commission poses a variety of questions regarding the conditions for providing additional flexibility in the price cap plan. Issues 10 and 11 repeat questions that have already been answered in response to the types of changes the Commission should make to the price cap rules. Interestingly, there is a conflict within the Second Notice regarding the conditions 'hat need to be present before additional flexibility is introduced into the price cap plan. With regard to Issue 10, the Commission concludes that LECs should be able to take advantage of all new pricing flexibility and other relief immediately:

> We propose that LECs be permitted to take advantage of any or all of the relief and flexibilities proposed in this Section IV. B. at their discretion. All

> of our proposals are designed to encourage the expeditious introduction of new services and give LECs increased flexibility to reduce rates. We do not believe that the cumulative effect will cause competitive harm.[56]

Nevertheless, the Commission goes on to suggest in Issue 11 that additional pricing flexibility might be predicated on a demonstration that certain barriers to competitive entry into the local services market have been removed.[57]

In response to the Commission's request for specific changes to the price cap rules, BellSouth demonstrated that each of the proposed modifications should be made immediately in order to improve the efficiency and, hence, the performance of the price cap rules. The modifications are not predicated on the presence of competition. To the contrary, they are necessary in the absence of competition.

The Commission should keep in mind its own finding that the purpose of regulation is to emulate the competitive marketplace. The proposed modifications to the price cap rules eliminate unnecessary regulations and constraints so that the LEC can engage in the same type of market behavior as a competitive firm, e.g., reducing prices and introducing new services. It is illogical to suggest that the LECs should be prevented from acting like a competitive firm until there is some demonstration that competition is present.

The presence of competition should be the basis for removing regulation. It should not be used as an excuse to refrain from making regulation more efficient. Neither

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56. Second Notice at ¶ 104.

57. Id. at ¶ 107. The Commission has tentatively concluded that "lowering entry barriers is the most appropriate mechanism for conditioning additional price cap flexibilities because additional flexibilities within the price cap framework are forms of regulatory relief that are intended to allow the LECs to respond to emerging competition, and in some cases that allow efficient competition to occur." Id. at ¶ 106.

the public interest nor competition is served by artificially limiting the LECs' ability to reduce prices or to introduce new services. While individual competitors can benefit when the Commission is slow to improve the regulatory process, such an outcome is neither desirable nor pro-competitive.[58]

The Commission must maintain the distinction between improving price cap regulation and providing regulatory relief associated with the emergence of competition. Improving price cap regulation should result in a set of rules that maximizes the incentives and efficiency of the price cap plan and thereby maximizes the benefits to consumers. Competition challenges the need for regulation altogether. The presence of competition should bring with it the removal of price cap regulation, not its modification.

I. Procedural Matters.

Issue 12

What is the best procedural mechanism for price cap LECs to use when seeking regulatory relief or pricing flexibility within the price cap plan?

The Second Notice seeks comment on the best procedural mechanism for price cap LECs to use when seeking regulatory relief or pricing flexibility within the price cap plan.[59] The Commission must distinguish between two different types of changes: those that improve the performance and efficiency of the price cap plan and those that reduce regulation due to competition (e.g., adaptive regulation).

58. See Hausman Statement at ¶ 25 (stating that "regulation should not be used to keep telecommunications prices perversely high to protect competitors").

59. Second Notice at ¶ 115.

The changes that constitute baseline efficiency and performance improvements would include the removal of the lower limit on price changes, the modifications to the new service rules and the changes to the basket and service category definitions. These additional flexibilities require no procedural steps for implementation, and should be self executing. A procedural approach need only be defined for streamlining regulation or for declaring a LEC nondominant. The procedures relate to the relaxation of regulation, the end result of which is a determination that the price cap rules cease to apply.

Ultimately, the Commission should proceed carefully to ensure that price cap procedural mechanisms do not become a regulatory morass from which no LEC will ever successfully extricate itself. The procedure for streamlining or nondominance should consist of no more than a requirement that the LEC file a petition accompanied by a showing that the LEC satisfies the conditions for such relaxed regulation.[60] A firm timeline should also be specified. For example, the procedural rules should call for a disposition of the petition within 60 days. Because the criteria for relaxed regulation will not be at issue, the only question to be answered will be whether the criteria have been satisfied. An extended period of time for review is therefore unnecessary.

III. A PLAN FOR ADAPTIVE REGULATION OF THE LECs

Recognizing that competition for local services (including interstate exchange access) is accelerating, the Second Notice solicits comment on a series of questions regarding streamlining and nondominance that contemplate a framework for anticipating and

60. Elsewhere in the Second Notice, the Commission considers the criteria that should be satisfied to achieve streamlining and nondominant status.

encouraging the development of competition. BellSouth endorses efforts by the Commission to put into place a plan for adaptive regulation. The Commission cannot and should not expect an efficient, technologically advanced and globally competitive telecommunications industry that operates in an environment characterized by rapid and expansive change to be confined by a system of"snapshot" regulations that is reflective of only a single point in time. Instead, the regulations must be self-correcting. Otherwise, the regulatory process inhibits change and forestalls the benefits that competition would otherwise yield.

The Commission has long recognized that in competitive markets, the interaction of market forces is the best means of providing economic incentives and assuring just and reasonable rates.[61/] Correspondingly, the retention of unnecessary regulations can have undesirable consequences by insulating industry participants from competition. Regulation can create and maintain a structure of prices that are considerably above competitive levels.[62/] In these circumstances, regulation is not only superfluous but harmful to the public interest.

The primary question confronting the Commission is how best to establish a plan that reduces regulation commensurate with the presence of competition. Contrary to the suggestion in the Second Notice, the answer should not be tied to relevant market definitions. Indeed, the Commission recognized this fact in its adaptive regulation plan for the interexchange market. Notwithstanding the Commission's view that there is a single product

61. See e.g., Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, 5 FCC Rcd 2627, 2638 (1990).

62. See Hausman Statement at ¶ 11 ("Regulation often leads to a large distortions in prices.").

market for all interexchange services,[63] the Commission did not tie its plan to the relevant market. Instead, it looked at individual groups of services, and streamlined regulation for those service groups where it determined that reducing regulation and allowing market forces to interact would achieve better economic performance than regulation.[64] As part of these determinations, the Commission took into account and evaluated the effect that streamlining certain services would have on the regulation of other services, in order to ensure that there would be no policy conflicts.

A similar approach should be developed be developed for LEC services, recognizing that there are multiple regulatory influences that tend to segment the local exchange and access market. All of these influences are in a state of flux due to changes in regulatory policies -- some of which are Commission-initiated and some of which are legislatively directed. The transformation that the marketplace continues to undergo will demand that the plan for reducing regulation have criteria flexible enough for streamlining and nondominance to apply in a variety of circumstances. Therefore, the adaptive regulatory rules must allow for changing the scope of service segments that are candidates for reduced regulatory treatment as the underlying nature of competition itself adapts to technological and regulatory changes.

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63. Second Notice at ¶117.

64. See Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, 6 FCC Rcd 5880 (1991).

A. Relevant Product Market.

Issue 13

Should we use the existing price cap service categories within the baskets to define the relevant product market?

As a starting point to identify services that should be subject to reduced regulatory scrutiny and additional flexibility, the use of price cap service categories could be a workable approach. The presumption, of course, is that the service categories would be modified in the manner suggested by BellSouth in Part II above.

The current service categories and subindices that the Second Notice proposes to use to define categories for the purposes of granting regulatory relief are too splintered and unrelated to marketplace realities to be of any utility. For example, the numerous service categories and subindices within the Trunking Basket do not define markets, nor are they reflective in the manner in which competition is developing. Competition has developed for transport services as a whole. The competitive networks that exist today were deployed with the intention of meeting any form of transport demand. Technologically, these competitive networks are fiber-based and are capable of carrying the full array of transport services offered by LECs.

For example, Time Warner Communications Tariff FCC No. 1 sets forth a full array of transport services that are available from Time Warner's affiliated alternative access providers. The services offered by these competitors include:

a. OC-12 Service

b. OC-3 Service

c. DS3 Service

d. DS1 Service

e. DS0 Service

f. Analog Voice Grade Service

g. Switched Access Transport

Time Warner's tariff also provides for custom services. Custom services encompass any capability not specifically described or that calls for nonstandard arrangements.[65] All of these transport services share a common network.

The existing service categories reflect initial regulatory uncertainty in implementing price cap regulation for LECs. The establishment of the existing service categories or subindices was not intended to create the foundation for analysis of future regulatory flexibility. Even from a price cap perspective, the Commission recognized that the service categories and subindices introduced economic inefficiencies to the price cap plan. Embedding these regulatory inefficiencies in the name of adding flexibility makes no sense.

For the Trunking basket, the Commission should consider the substitutability of supply as the predominant factor in proceeding to reduce regulation. For transport services, LECs and their competitors each use a common network to provide the full range of transport services to access customers. If the Trunking basket were to be divided for the purposes of streamlining, then tandem switched transport initially might be separated from the other transport services. However, segregating tandem switched transport can be misleading because equivalent transport arrangements can be created through the use of ring

65. Time Warner Communications Tariff FCC No. 1 Section 3.3.8.

topologies and ATM nodal configurations. The Commission must avoid the temptation to believe that to compete with LEC services competitors need to recreate LEC networks in their entirety. Technology enables to competitors to provide similar functionality using far simpler network configurations. The Trunking Basket (excluding the Interconnection Charge) thus would be considered a discrete service grouping for the purpose of streamlining.

For the Traffic Sensitive basket, if the Commission modifies the service categories as BellSouth suggested in response to Issue 7, then the service categories would represent service groupings around which competition is and will continue to develop. Unlike transport services, competitors can choose the types of services they want to provide. Thus, there may be competitors who focus exclusively on providing alternative switched access services. Others may concentrate on operator and directory assistance services. The adaptive regulatory plan must be flexible enough to accommodate such developments, and using service categories in the Traffic Sensitive basket provides a reasonable means to do so.

The common line basket has no service categories. The basket, however, should be considered together with the local switching service category for the purpose of providing additional flexibility as competition develops. LEC competitors, such as cable companies, eventually will provide a complete switched access service using their own networks; initially, they may use a combination of alternative network facilities and resold LEC facilities. Regardless of the way competition evolves, however, the Commission should be prepared to permit the switched access market forces to operate unfettered by Commission